Office-Supreme Court, U. S.
FILED
NOV 29 1950
CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 400

CRANE COMPANY, A CORPORATION UNDER THE LAWS OF THE STATE OF ILLINOIS,

Petitioner,

vs.

SAM K. CARSON, COMMISSIONER OF FINANCE & TAXATION OF THE STATE OF TENNESSEE

ON PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF TENNESSEE

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

WILLIAM F. BARRY,
Solicitor General of Tennessee,
Counsel for Respondent.

INDEX

Subject Index

	Page
Opinions below	1
Jurisdiction	5
Question presented	9
Statute involved	13
Statement of the case and argument	13
Conclusion	17

Table of Cases Cited

American Bemberg Corporation v. *Carson*, 188 Tenn. 263, 219 S. W. 2d 169 ..... 8, 10, 11, 12, 13

Bass, Ratcliff & Gretton v. *State Tax Com.*, 266 U. S. 271, 45 S. Ct. 82, 69 L. Ed. 282 ..... 11, 14

Butler Brothers v. *McColgan*, 315 U. S. 501, 62 S. Ct. 701, 86 L. Ed. 991 ..... 4, 5, 9, 10, 11, 15

Ford Motor Co. v. *Beauchamp*, 308 U. S. 331, 60 S. Ct. 273, 84 L. Ed. 304 ..... 11, 15

General Shoe Corp. v. *Stokes*, 181 Tenn. 286 ..... 8, 10, 11, 12

Hans Rees' Sons v. *North Carolina*, 283 U. S. 123, 55 S. Ct. 385, 75 L. Ed. 87 ..... 6, 10, 16

International Harvester Co. v. *Evatt*, 329 U. S. 416, 67 S. Ct. 444, 91 L. Ed. 390 ..... 9, 10, 13

Maxwell, State ex rel. v. *Kent-Coffey Mfg. Co.*, 204 N. C. 365, 168 S. E. 397, 90 A.L.R. 476 (aff'd. 291 U. S. 642) 12

Memphis Natural Gas Co. v. *Beeler*, 315 U. S. 649, 62 S. Ct. 857, 86 L. Ed. 1090 11

Pennsylvania v. *Ford Motor Co.*, 350 Pa. 336, 38 A. 2d 329 12

Reynolds Tobacco Co. v. *Carson*, 87 Tenn. 157, 213 S. W. 2d 45 ..... 8, 10

Underwood Typewriter Co. v. *Chamberlain*, 254 U. S. 113, 41 S. Ct. 45, 65 L. Ed. 165 ..... 9, 12, 14

United States Glue Co. v. *Oak Creek*, 247 U. S. 321, 38 S. Ct. 499, 62 L. Ed. 1135 ..... 10, 14

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 400

CRANE COMPANY, A CORPORATION UNDER THE LAWS OF THE STATE OF ILLINOIS,

Petitioner,

vs.

SAM K. CARSON, COMMISSIONER OF FINANCE & TAXATION OF THE STATE OF TENNESSEE,

Respondent

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

May It Please the Court:

Pursuant to the rules of the Supreme Court of the United States (Rule 38, Section 3) the respondent, Sam K. Carson, Commissioner of Finance and Taxation of the State of Tennessee, submits the following brief in opposition to granting the petition for certiorari prayed for in this cause by petitioner Crane Company.

Opinions Below

Petitioner Crane Company, an Illinois corporation, is engaged in the unitary business of manufacturing and selling plumbing and heating supplies (R., p. 73).

Its manufacturing plants are located at Chicago, Illinois, Trenton, New Jersey, and Chattanooga, Tennessee. It has 130 sales branches in the principal cities of the United States (R., p. 73). Included among the sales branches maintained by petitioner are sales branches at Knoxville, Tennessee, Chattanooga, Tennessee, Memphis, Tennessee, and Nashville, Tennessee (R., pp. 75-76).

The question presented in this case to the lower courts, the Chancery Court of Davidson County, Tennessee, and the Supreme Court of Tennessee, was whether the application of the Tennessee statutory formula for arriving at petitioner's net earnings taxable by the State under the Tennessee corporation excise tax and franchise tax formulas, violated the due process clause of the Fourteenth Amendment.

The petitioner insisted before the lower courts that it was entitled to a departure from the statutory formulas and was entitled to have its taxes calculated under a special hardship formula based upon its own system of separate accounting.

Although engaged in a unitary business of manufacturing and selling plumbing and heating supplies, the petitioner seeks to require the State of Tennessee to use petitioner's own system of separate accounting in computing net earnings subject to State taxation. The record shows that petitioner's system of separate accounting treats the Chattanooga manufacturing division as a separate entity and the selling branches as separate entities. The separate accounting insisted upon by petitioner does not take into account the selling profit made on sales of products manufactured at Chattanooga, Tennessee (R., p. 96).

The opinion of the trial court, the Chancery Court of Davidson County, is unreported, and the opinion of the Supreme Court of Tennessee is likewise unreported, pending the action of this Court upon the petition for certiorari.

The opinion of the Chancellor is found in the record on pp. 134-138. The opinion of the Supreme Court of Tennessee is found in the record on pp. 140-146.

(a) The Opinion of the Chancellor

The Chancellor, after carefully reviewing the facts of the instant case (R., pp. 134-138), held that the application of the statutory excise and franchise tax formulas to petitioner did not result in violation of the due process clause of the Fourteenth Amendment. He further held that the law of the case was controlled by the recent decision of the Supreme Court of Tennessee in *American Bemberg Corporation* v. *Carson* (March, 1949), 188 Tenn., 263. In that case the Supreme Court of Tennessee reviewed extensively the decisions of the Supreme Court of the United States relating to the allocation of a corporation's net income for taxation where the corporation was doing a unitary business in more than one state.

The Chancellor concluded his opinion by holding that: "From all the foregoing the Court has reached the conclusion that the complainant is engaged in a unitary business; that the Commissioner has not abused his discretion in not allowing the hardship formulas; and that the application of the formulas contained in the excise and franchise taxing statutes has not resulted in an arbitrary and palpably disproportionate allocation to Tennessee of income actually earned in another state, or net worth actually employed outside the borders of Tennessee."

Chancellor's Opinion, Record, p. 138.

(b) The Opinion of the Supreme Court of Tennessee

The opinion of the Supreme Court of Tennessee appears in the Record at pp. 140-146. After again reviewing the facts of the instant case, the Supreme Court of Tennessee

discussed in some detail the applicable decisions of the Supreme Court of the United States, particularly *Butler Brothers* v. *McColgan*, 315 U. S. 501, 86 L. ed., 991, and held in conclusion the following:

> "We find nothing in this record to indicate an abuse of discretion by the Commissioner in refusing to apply a hardship formula, and in applying the regular statutory formulas for collection of franchise and excise taxes from the Complainant, since application of the statutory formulas resulted in following percentages for the purpose of excise and franchise taxes for the years in question:

(Fols. 188-189)	Excise	Franchise
1947	9.6586%	13.3532%
1946	8.1527%	10.6860%
1945	5.3189%	6.7945%

> "When these percentages are considered in the light of Complainant's annual payrolls, capital expenditures for enlargement and improvement of its plant, and its net income for the years involved, which figures we have quoted earlier in this opinion, there is nothing to indicate that application of the statutory formulas did not produce a fair and just result, nor to indicate that any right of the Complainant under the 14th Amendment was infringed.
>
> "Only when the application of the statutory formulas results in an arbitrary and 'palpably disproportionate' allocation to the State of income actually earned in another state, or net worth actually employed outside the borders of the taxing state, is there a violation of the 14th Amendment. International Harvester Co. vs. Evatt, 329 U. S., 416, 91 L. ed., 390, American Bemberg Corp. vs. Carson, supra, and Reynolds Tobacco Co. vs. Carson, supra. Mathematical nicety and precision of assessment is not required. All that is required for the protection of the taxpayer is that the assessment be fairly calculated to assign to Tennessee only that portion of net income and net worth reasonably attribu-

table to business done in this State. General Shoe Corp. vs. Stokes, supra, at page 289, citing Butler Bros. vs. McColgan, supra; Ford Motor Co. vs. Beauchamp, 84 L. ed., 304; Bass, Ratcliff & Gretton, Ltd. vs. State Tax Commission, 69 L. ed., 282.

"On the authorities cited, and for the reasons stated, all assignments of error are overruled, and the Chancellor's decree is affirmed."

Opinion of Supreme Court of Tennessee, Record, p. 146.

It is material to note that the opinion of the Supreme Court of Tennessee fully concurs with the opinion of the trial court as rendered by the Chancellor.

Jurisdiction

Certiorari should be denied in the instant case because there is no conflict between the decision of the State court and the decisions of this Court. On the contrary, the opinion of the Supreme Court of Tennessee is in full accord with the decisions of this Court. It follows particularly *Butler Bros.* v. *McColgan* (1942), 315 U. S. 501, 62 S. Ct. 701, 86 L. ed. 991, which was decided basically upon the same facts and propositions of law as the instant case.

The petition presents no new question. Petitioner is engaged in a unitary business and seeks to substitute its own system of separate accounting in place of the statutory formulas, which is not permitted by statute.

The Tennessee excise and franchise statutes (which appear in the appendix of this brief) do not authorize separate accounting. The rule of law in the absence of statute with reference to arriving at net income *of a unitary business* has been recognized as follows:

"It is obvious, however, that a separate accounting, no matter how detailed, *is basically false if the business done in more than one state is of a unitary character,*

> that is, if the business done in any state benefits the business done elsewhere and is benefited by the business done elsewhere because of the distribution of processes and operations, centralized management, increased buying power, volume reduction of manufacturing cost, or other factors of the business as a unit. If the business is of that character apportionment by formula may be required, except, as pointed out above, if the result is obviously unreasonable in a particular case. Except in that case, a right to a separate accounting must be found, if at all, in the statute or administrative regulations." (Emphasis added.)
>
> Altman and Keesling, Allocation of Income in State Taxation, p. 38.

The exception referred to in the above quotation is *Hans Rees' Sons* v. *North Carolina,* 283 U. S. 123, 55 S. Ct. 385, 75 L. ed. 87, which case is fully and completely distinguished from the present case later in this brief.

On page 2 of petitioner's brief, under the caption "Jurisdiction," the statement is made: "The accuracy of which separate accounting the Tennessee Court expressly acknowledged (R., p. 135)."

Respondent submits that the quoted statement is unintentionally but definitely misleading. At Record p. 135 the Chancellor used this exact language: "No question is raised *as to the accuracy of the bookkeeping records* which complainant maintained." (Emphasis added)

The accuracy of bookkeeping records is one thing, while the accuracy of separate accounting "in principle" is quite another. There should be added the remainder of the Chancellor's statement, which appears in his opinion at Record p. 137 as follows: "The fact that complainant kept its books in such a manner as to show separate manufacturing costs in Tennessee does not take it out of the unitary class and there is no holding in the *Bemberg* case to the

contrary. One of the grounds on which complainant undertakes in its brief to distinguish the *Bemberg* case is that profit from manufacturing in Tennessee was not reflected therein. *Under the unitary principle a separation of manufacturing profit or loss in this State would not be permissible.''* (Emphasis added) (R., p. 137).

The most that might be said of petitioner's statement above referred to is that no question was raised as to the bookkeeping records.

A question was definitely raised, however, as to the system of bookkeeping, or the use of different systems of bookkeeping and accounting (R., p. 97).

Petitioner's witness Kaiser admitted on cross-examination that different manufacturing corporations use different systems of bookkeeping and accounting, and that accountants disagreed among themselves as to which was the better way of reflecting a given subject in a set of books. The witness was then asked the specific question:

> ''X Q. 75. And while your system of bookkeeping shows a loss at the Chattanooga factory in 1945 and 1946, another system of bookkeeping might have shown an even bigger loss, and another system of bookkeeping might have even shown a profit in those years,—it not?
>
> ''A. That is possible.''
>
> Record p. 97.

In the final analysis, it was incumbent upon the lower courts to apply the statutory formulas unless such application resulted in an arbitrary and palpably disproportionate allocation to Tennessee of income earned in another state or net worth actually employed outside the borders of Tennessee. Under *Butler Bros.* v. *McColgan, supra,* petitioner's own system of separate accounting did not have to be accepted by the taxing officials in lieu of the formulas required by statute.

On page 11 of petitioner's brief, under the caption "Reasons for Granting the Writ," petitioner refers to "a series of decisions against corporations doing business in Tennessee who have also complained of unjust treatment by Tennessee in taxation under these statutes." In the footnote, four cases are referred to. Two of those cases, *American Bemberg Corp.* v. *Carson, North American Rayon Corp.* v. *Carson,* 188 Tenn. 263, were companion cases, and no appeal or petition for certiorari was filed to this Court. The same situation was true in *General Shoe Corp.* v. *Stokes,* 181 Tenn. 286, which was decided in 1944.

The remaining case referred to, *Reynolds Tobacco Co.* v. *Carson,* 187 Tenn. 157, did not involve formulae, but involved "warehouse operations." On page 163 the Supreme Court of Tennessee stated:

> "The only question on these formulae presented on this appeal *is whether the warehouse operation of the complainant* is to be construed as 'sales made through or by officers, agencies, or branches located in Tennessee.'"
>
> *Reynolds Tobacco Co.* v. *Carson, supra.*

In reality, therefore, the "situation to be corrected," insofar as complaints as to the Tennessee excise and franchise tax formulas are concerned, consists of one appeal to the Supreme Court of Tennessee in 1944, and the appeal of two companion cases in 1949. As before stated, neither of these cases was sufficiently meritorious to warrant petition for certiorari to the Supreme Court of the United States.

Reference to the excise and franchise statutes which appear in the appendix of this brief will show that they have been the law of Tennessee for more than 13 years, being enacted in 1937. The allocation formulas contained in those

statutes have been applied in the case of thousands of corporations which have been doing business in Tennessee during that long period of years. Learned adversary counsel has clearly pointed out by indirection that the State of Tennessee has fared much better than her sister states in the matter of litigation with her corporate taxpayers and in the matter of appeals or petitions for certiorari from the Supreme Court of Tennessee.

There is no showing in this record that petitioner has been denied due process under the Fourteenth Amendment or is entitled to preferential treatment over other corporate taxpayers.

Question Presented

The question presented in this case is whether the application of the statutory excise and franchise tax formulas to petitioner results in violation of the due process clause of the Fourteenth Amendment.

It is the insistence of respondent that the following propositions of law and supporting authorities, when considered with the facts of the case, definitely negative petitioner's contention alleging violation of the due process clause of the Fourteenth Amendment:

I

The use of statutory formulas as a method of allocating income and net worth of corporations doing business in more than one state is strongly sanctioned by the Courts.

International Harvester Co. v. *Evatt* (1947), 329 U. S. 416, 67 S. Ct. 444, 91 L. Ed. 390;

Butler Bros. v. *McColgan* (1942), 315 U. S. 501, 62 S. Ct. 701, 86 L. Ed. 991;

Underwood Typewriter Co. v. *Chamberlain* (1920), 254 U. S. 113, 41 S. Ct. 45, 65 L. Ed. 165;

United States Glue Co. v. *Oak Creek* (1920), 247 U. S. 321, 38 S. Ct. 499, 62 L. Ed. 1135, Am. Cas. 1918E, 748;

American Bemberg Corporation v. *Carson,* 188 Tenn. 263, 219 S. W. 2d 169;

R. J. Reynolds Tobacco Co. v. *Carson,* 187 Tenn. 157, 213 S. W. 2d 45;

General Shoe Corporation v. *Stokes,* 181 Tenn. 286.

II

Only when the formula results in an arbitrary and "palpably disproportionate" allocation to the state of income actually earned in another state or net worth actually employed outside the borders of the taxing state is there a violation of the 14th Amendment or commerce clause.

International Harvester Co. v. *Evatt* (1947), 329 U. S. 416, 67 S. Ct. 444, 91 L. Ed. 390;

Hans Rees' Sons v. *North Carolina* (1931), 283 U. S. 123, 51 S. Ct. 385, 75 L. Ed. 87;

American Bemberg Corporation v. *Carson,* 188 Tenn. 263, 219 S. W. 2d 169;

R. J. Reynolds Tobacco Co. v. *Carson,* 187 Tenn. 157, 213 S. W. 2d 45.

III

A statutory allocation formula which apportions a reasonable amount of the net earnings and net worth of a unitary corporation to a state will be sustained, even though the corporation's own system of separate accounting shows a loss from operations in that state.

Butler Bros. v. *McColgan* (1942), 315 U. S. 501, 62 S. Ct. 701, 86 L. Ed. 991.

1. A unitary corporation is not entitled to separate its manufacturing operations from its sales operations for tax purposes.

American Bemberg Corporation v. *Carson,* 188 Tenn. 263, 219 S. W. 2d 169.

(And decisions of the United States Supreme Court cited therein.)

IV

A state may impose a tax upon the privilege of doing business in corporate form measured by net earnings arising from business done in the State in interstate commerce, and from net worth employed in the State in interstate commerce. without violating the Commerce Clause or imposing an unconstitutional burden on interstate commerce.

Memphis Natural Gas Co. v. *Beeler* (1942), 315 U. S. 649, 62 S. Ct. 857, 86 L. Ed. 1090;

Butler Bros. v. *McColgan* (1942) 315 U. S. 501, 62 S. Ct. 701, 86 L. Ed. 991;

Ford Motor Co. v. *Beauchamp* (1940), 308 U. S. 331, 60 S. Ct. 273, 84 L. Ed. 304;

Bass, Ratcliff & Gretton v. *State Tax Com.* (1924), 266 U. S. 271, 45 S. Ct. 82, 69 L. Ed. 282;

American Bemberg Corporation v. *Carson,* 188 Tenn. 263, 219 S. W. 2d. 169;

General Shoe Corp. v. *Stokes,* 181 Tenn. 286;

Memphis Natural Gas Co. v. *McCanless,* 180 Tenn. 695.

V

The bare fact of sale produces no income. The sale is merely the act by which the income is captured. The capital, the organization, the efforts which produce the sale, are the things to be considered in ascertaining the amount of

income to be credited to the sale. In a unitary business the Court will look further back than the sale itself or the activities which produced it in determining whether or not a statutory allocation formula offends against the Fourteenth Amendment or the Commerce Clause.

State ex rel. Maxwell v. *Kent-Coffey Manufacturing Co.* (1933), 204 N. C. 365, 168 S. E. 397, 90 A. L. R. 476 (Affirmed 291 U. S. 642, 54 S. Ct. 437, 78 L. Ed. 1040);

American Bemberg Corporation v. *Carson,* 188 Tenn. 263, 219 S. W. 2d 169.

VI

Intangibles located outside the State, if a part of the working capital of a unitary corporation, are a proper and constitutional measure of state taxes upon the privilege of doing business in corporate form. It is not necessary for an allocation formula to contain a ratio representing intangibles, since the Legislature is not required to seek out and apply every possible permutation and combination of measure.

Commonwealth of Penna. v. *Ford Motor Co.* (1944), 350 Pa. 336, 38 A. 2d 329 (Dismissed 324 U. S. 827, 89 L. Ed. 1394);

American Bemberg Corporation v. *Carson,* 188 Tenn. 263, 219 S. W. 2d 169.

VII

The burden of proof rests upon the taxpayer to establish that a statutory allocation formula results in a violation of the Fourteenth Amendment or the Commerce Clause.

Underwood Typewriter Co. v. *Chamberlain* (1920), 254 U. S. 113, 41 S. Ct. 45, 65 L. ed. 165;

General Shoe Corporation v. *Stokes,* 181 Tenn. 286.

VIII

The authority vested by the Legislature in the Commissioner of Finance and Taxation and the Attorney General to grant special hardship allocation formulas in extreme cases is discretionary and will not be coerced by the courts in the absence of clear and cogent evidence that the discretion has been abused.

American Bemberg Corporation v. *Carson,* 188 Tenn. 263, 219 S. W. 2d 169.

Statutes Involved

The relevant provisions of the Tennessee excise and franchise tax statutes are printed and included in Appendix A to this brief at pages 18-23.

Statement of the Case and Argument

Tennessee, like other states, is faced with a difficult problem when it seeks to apply the excise and franchise taxes to corporations which do business in more than one state. What part of the net earnings arise from business done in Tennessee? What portion of the capital stock, surplus and undivided profits is properly related to business done in Tennessee?

To meet these problems uniformly—to apply a method of allocation which treats alike all corporations, domestic and foreign, without discrimination—the Legislature of Tennessee, in 1937, adopted a system of statutory allocation formulas, known as the "Massachusetts formulas." This system of allocation, with some variation of details, is in use in most of the states imposing tax on corporations for the privilege of doing business or levying corporate net income taxes. With very few exceptions, these formulas have been approved by the courts.

Many of the statutory formulas which have received judicial approval are based on the single factor of property owned in the state as compared to property owned everywhere. To avoid a disproportionate emphasis upon the property factor, and to reach a more equitable basis of allocation, Tennessee's system of corporate taxation for manufacturing corporations gives recognition to three factors: (1) property; (2) manufacturing costs; and (3) sales.

The basic principle of these statutory allocation formulas is to prevent double taxation and to permit each state to tax every corporation, both domestic and foreign, in proportion to the value of its privilege of doing business within said state. In the instant case there is concededly no double taxation as between Tennessee and other states, since only 67.40% of petitioner's net earnings in 1945, 35.14% in 1946 and 38.54% in 1947 were taxed in all states combined (R. p. 107).

Such formulas are designed to reach approximate accuracy and do substantial justice. Obviously they cannot attain mathematical precision in every instance. Such formulas are supported by the overwhelming weight of judicial authority. Only when the result is arbitrary and "palpably disproportionate"—when the measure of the tax includes income actually earned in another state or net worth actually employed beyond the borders of the taxing state and having no relation to the operations in the taxing state—have the courts disapproved the formula method of allocation.

For more than thirty years the system of statutory allocation formulas has been applied with judicial approval.

United States Glue Co. v. *Oak Creek* (1918), 247 U. S. 321, 31 S. Ct. 499, 62 L. ed. 1135;

Underwood Typewriter Co. v. *Chamberlain* (1920), 254 U. S. 113, 41 S. Ct. 45, 65 L. ed. 165;

Bass, Ratcliff & Gretton v. *State Tax Com.* (1924), 266 U. S. 271, 45 S. Ct. 82, 69 L. ed. 282.

It is unnecessary to reiterate the facts or the holding of this Court in *Butler Bros.* v. *McColgan* (1941), 315 U. S. 501, 62 S. Ct. 701, 86 L. ed. 991, or the *Ford Motor Co.* v. *Beauchamp* (1940), 308 U. S. 331, 60 S. Ct. 273, 84 L. ed. 304, or *International Harvester Co.* v. *Evatt* (1947), 329 U. S. 416, 67 L. ed. 390.

In the instant case there is no doubt that petitioner is engaged in a unitary business within the meaning of the foregoing decisions. It is not feasible to enter into an extensive analysis of petitioner's accounting, but for the tax years involved in this litigation, 1945, 1946 and 1947, the following figures are revealing and definitely strip petitioner's claim of any equity.

For the years in question petitioner had net income from its unitary operations, after payment of Federal taxes, as follows (R. p. 107):

1945—$5,280,209.00
1946—10,342,949.00
1947—15,418,357.00

During the same years petitioner paid dividends to its stockholders as follows (R., p. 108):

1945—$3,833,161.80
1946— 4,709,067.75
1947— 6,691,058.00

During the years in question the number of employees at Chattanooga has increased more than 300%, from 623 to 2300, and the growth of the payroll is shown by the following figures (R., p. 62):

Annual Payrolls—Chattanooga

1945—$1,523,367.19
1946— 3,171,517.87
1947— 4,509,060.51

The Court will likewise note a comparable increase in the total raw material purchases at Chattanooga (R., p. 65).

It is obvious that petitioner's system of bookkeeping and effort to separate the manufacturing and selling operations of what is unquestionably a unitary business has resulted in petitioner making a selling profit on articles claimed to have been produced at a manufacturing loss, prices on the articles having been materially increased during the post-war years (R., pp. 104-105).

The foregoing resume shows that there can be no merit to petitioner's contention as based upon the facts of the case. Petitioner has relied (at page 9 of his brief) upon *Hans Rees' Sons* v. *North Carolina* (1931), 282 U. S. 123, 51 S. Ct. 385, 75 L. ed. 879. The *Hans Rees* case, however, can have no application upon the case at bar. In that case the Court gave emphasis to buying skill as involved in the leather industry. In the present case the essential part is not buying skill but manufacturing skill, whereby raw materials are transformed into useful articles. In the *Hans Rees* case part of the processing was done outside of the manufacturing state, in that leather was cut into small parts to meet the needs of customers, and other such processing carried on outside the manufacturing state so as to derive a "selling profit" or, in other words, provide an independent basis for a selling profit separate from the manufacturing state. In the instant case the petitioner's manufacturing process is completed in Tennessee. These are but two points for consideration but it is further asserted that there is no substantial similarity between the detailed facts of the two cases.

It is not contended that the *Hans Rees* case has been overruled. It presents an example of what the court regarded as an extreme hardship under an allocation formula, but under its own terms it would not be applied by the

Court in any case except where a petitioner has carried the burden of showing a patently disproportionate allocation.

There is contained in Yale Law Journal, Vol. 40, p. 1273, a thorough review of the *Hans Rees* case as affecting interstate allocation of corporate income for taxing purposes. The numerous decisions of the courts upon this question are referred to and reviewed in that article and it is apparent that even with the extreme facts of the *Hans Rees* case it is completely out of harmony with all the other decisions. The later decisions of this Court, according to our view, have effectually stripped it of any value except as the rule might be applicable under extreme facts and where the corporation has carried the burden of proof of showing an arbitrary and unconscionable allocation.

Conclusion

In conclusion we reemphasize that statutory allocation formulas are designed to produce substantial justice by treating all taxpayers alike. So long as the result is not inherently arbitrary there is no infringement of the Fourteenth Amendment.

Upon the facts of this case as shown from the record, and as reviewed by the Supreme Court of Tennessee, and upon the law of the case as heretofore submitted in this brief, respondent respectfully submits that the case has been correctly decided by the Supreme Court of Tennessee; that the petition for certiorari is without merit and should be denied.

Respectfully submitted,

WILLIAM F. BARRY,
Solicitor General of Tennessee,
204 Supreme Court Building,
Nashville, Tennessee,
Counsel for Respondent.

November, 1950.

APPENDIX A

Tennessee Corporate Excise Tax

(Relevant Sections)

Code of Tennessee, Section 1316:

1316. Tax imposed.—All corporations, cooperatives conducted for profit, joint-stock associations and business trusts, organized under the laws of the State of Tennessee, other than those organized for general welfare and not for profit, and all such entities organized under the laws of any other state or country for profit and doing business in Tennessee, shall, without exception, pay to the commissioner of finance and taxation annually an excise tax, in addition to all other taxes, equal to three and three-quarters per cent. (3.75%) of the net earnings for their next preceding fiscal or calendar year, from business done within the state.

In the case of corporations, cooperatives, joint-stock associations and business trusts doing business in Tennessee and elsewhere, the net earnings shall be apportioned as hereinafter set forth and the net earnings thus apportioned to Tennessee shall be deemed to be the earnings arising from business done within the state and shall be the measure of this tax. Such method of apportionment shall be as follows:

(1) If the principal business in this state is manufacturing or if it is any form of collecting, assembling or processing of goods or material, the entire net earnings shall be apportioned to Tennessee on the basis of the ratio obtained by taking the arithmetical average of the following three ratios:

(a) The ratio of the value of its real estate and tangible personal property in this state on the date of the close of the fiscal year is to the value of its entire real estate and tangible personal property, with no deductions on account of encumbrances thereon.

(b) The ratio of the total cost of manufacturing, collecting, assembling or processing within this state, to

the total cost of manufacturing, collecting, assembling or processing within and without the state.

(c) The ratio of the gross sales to customers within Tennessee is to the total gross sales from all sources.

(2) If the principal business in this state is selling, distributing, dealing in or using tangible personal property, the entire net earnings shall be apportioned to Tennessee on the basis of the ratio obtained by taking the arithmetical average of the following three ratios:

(a) The ratio of the value of its real estate and tangible personal property in this state on the day of the close of the fiscal year is to the value of its entire real estate and tangible personal property then owned by it, with no deductions on account of encumbrances thereon.

(b) The ratio of the total sales made through or by offices, agencies, or branches located in Tennessee during the income year to the total sales made everywhere during said year.

(c) The ratio of the gross sales to customers within Tennessee is to the total gross sales from all sources.

(3) If the principal business is other than the manufacture or sale of tangible property, such proportion as its gross receipts in Tennessee during the income year is to its gross receipts for such year within and without the state

If, because of peculiar or unusual circumstances inherent in a particular case, the application of the above formulas would work a hardship or injustice, the commissioner, upon application of the taxpayer and upon such showing, is authorized, with the approval of the attorney-general, to adopt such other method of apportionment as would be fair and just under the facts of the case.

Tennessee insurance companies shall pay on net earnings proportioned to premiums on policies on persons and property in this state. (1923, ch. 21, sec. 1; 1927, ch. 44, Modified; 1937, ch. 99, sec. 1; 1937, ch. 176, sec. 1.)

Tennessee Corporate Franchise Tax

(Relevant Sections)

Code of Tennessee, Sections 1248.143 et seq.:

1248.143. Tax imposed; rate and measure.—All corporations organized under the laws of the State of Tennessee, other than those organized for general welfare and not for profit, and all corporations organized under the laws of any other state or country for profit and doing business in Tennessee shall, without exception other than as provided in section 2 (Sec. 1248.144) hereof, pay to the commissioner of finance and taxation annually a privilege tax in addition to all other taxes, the rate and measure of which are hereinafter set forth. The tax hereby imposed shall be paid for the privilege of engaging in business in corporate form in this state and shall be in addition to all other taxes levied by any other act.

The tax hereinbefore levied shall also be paid by all business trusts, commonly known as Massachusetts Trusts for the privilege of doing business in Tennessee and the word "corporation" when used herein shall be deemed to include a business trust unless the particular context require a different meaning.

The privilege tax hereby imposed shall be a tax of fifteen cents (15¢) on the one hundred dollars ($100), or major fraction thereof, of the issued and outstanding stock, surplus and undivided profits of each such corporation as shown by the books and records of such corporation at the close of its last calendar or fiscal year preceding the making of the sworn report hereinafter required.

Where a corporation doing business without surplus or undivided profits has had the value of its capital stock impaired by operating deficits or other business losses, such as fire, flood, tornado, etc., and where such deficit or loss is carried upon the books and records of the corporation as an impairment of capital, the measure of the tax shall be diminished by such loss or deficit.

The value of the stock held by any corporation in any other corporation paying the tax herein levied upon such

second corporation shall be deducted from the measure of the tax.

The measure of the tax hereby imposed shall in no case be less than the actual value of the real and tangible personal property owned or used by such corporation in this state and no corporation when paying tax upon the minimum basis herein set forth shall be permitted to insist that the assessed valuation of real and tangible personal property in Tennessee is greater than the actual value thereof. This provision is intended to fix a minimum tax base and not to substitute the value of property owned or used in Tennessee for the measure of the tax hereinbefore provided.

The tax imposed by this act shall apply to corporations whose business is being conducted by a receivership or trusteeship appointed by any court of competent jurisdiction and shall continue to accrue until such time as the corporation has been actually and legally dissolved or withdrawn from this state.

The minimum tax payable under this act shall be ten dollars ($10.00).

The tax herein levied shall be a tax for state purposes only and no county or municipality shall have the power to levy a similar tax (1937, ch. 100, Sec. 1).

1248.144. Credit of payments by insurance companies as tax on gross premiums.—There shall be credited upon the tax hereby imposed such net amounts as are paid by insurance companies to this state as a tax upon gross premiums collected by them, not including the gross premium receipts tax paid by fire insurance companies for the purpose of executing the fire marshal law. There shall be no other credits (1937, ch. 100, Sec. 2).

1248.145. Apportionment of tax to Tennessee.—In the case of corporations doing business in Tennessee and elsewhere the measure of the tax as hereinabove set forth shall be apportioned to Tennessee for the purpose of taxation in the following manner:

(1) If the principal business in this state is manufacturing or if it is any form of collecting, assembling or processing goods or materials, the capital stock, surplus and

undivided profits shall be apportioned to Tennessee on the basis of the ratio obtained by taking the arithmetical average of the following two ratios:

(a) The ratio of the value of its real estate and tangible personal property in this state on the date of the close of the fiscal year is to the value of its entire real estate and tangible personal property, with no deductions on account of encumbrances thereon.

(b) The ratio of the total cost of manufacturing, collecting, assembling or processing within this State, to the total cost of manufacturing, collecting, assembling or processing within and without the state.

(2) If the principal business in this state is selling, distributing, dealing in or using tangible personal property, the captal stock, surplus and undivided profits shall be apportioned to Tennessee on the basis of the ratio obtained by taking the arithmetical average of the following two ratios:

(a) The ratio of the value of its real estate and tangible personal property in this state on the day of the close of its fiscal year is to the value of its entire real estate and tangible personal property then owned by it, with no deductions on account of encumbrances thereon.

(b) The ratio of the total sales made through or by offices, agencies, or branches located in Tennessee during the income year to the total sales made everywhere during said year.

(3) If the principal business is other than the manufacture or sale of tangible property, such proportion as its gross receipts in Tennessee during the income year is to its gross receipts for such year within and without the state.

If, because of peculiar or unusual circumstances inherent in a particular case, the application of the above formulas would work a hardship or injustice, the commissioner, upon application of the taxpayer and upon such showing, is au-

thorized, with the approval of the attorney-general, to adopt such other method of apportionment as would be fair and just under the facts of the case.

When corporations are doing business in Tennessee and elsewhere, only that part of the capital, surplus and undivided profits properly allocable to Tennessee by the manner of apportionment hereinabove set forth, shall be used as a measure of the tax subject to the other provisions of this act with reference to a minimum measure and minimum tax.

If the capital stock of a corporation which is a subsidiary of another corporation or closely affiliated therewith by stock ownership is inadequate for its business needs apart from credit extended or indebtedness guaranteed by the parent or an affiliated corporation, in determining the amount of capital, surplus and undivided profits of such corporation with respect to its liability for the tax imposed by this act, there shall be included in the measure of the tax the indebtedness owed to or guaranteed by the parent or an affiliated corporation. If necessary to apportion such indebtedness the methods of allocation heretofore set forth shall be used (1937, ch. 100, Sec. 3).